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Instructions on Trading Violations and Burden of Proof

Final Report

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- Spoofing/scalping
- Front-running research
- Front-running client orders
- Trading on the basis of insider information (insider trading)
- Price/volume manipulation
- Pump and dump fraud/price manipulation
- Sweeps
- Burden of proof

Abstract

NASD was contracted by the AMIR Program "to assist the JSC in developing Instructions to the Securities Law, 2002 describing trading activities prohibited under Sections (107)D, (108) and (109) of the Act" as well as "produce an Instruction (or other appropriate vehicle) for the JSC regarding the burden of proof that must be met in civil actions."

In response, NASD drafted a three-part document. Parts I and II relate to definition of prohibited trading activities while Part III relates to the definition of the burden of proof the Commission must meet in pursuing civil actions against rule violators. Part I explains the legal basis and rationale for the JSC to issue an instruction defining prohibited trading activities. Part II defines the following non-exclusive list of activities that constitute a violation of Articles (107), (108), and/or (109) of the Securities law: trading away, wash sales/pre-arranged trading (wash sales), marking the open/close (marking), spoofing/scalping, front-running research, front-running client orders, trading on the basis of insider information (insider trading), price/volume manipulation, and pump and dump fraud/price manipulation. Part III provides the background to, and legal basis for, establishing a "preponderance of the evidence" standard for civil enforcement actions taken by the JSC.

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Executive Summary

The attached document presents to the Board of the Jordan Securities Commission (hereinafter referred to as the "Commission") two draft instructions for its consideration. The first, entitled "Instruction on Trading Violations", defines and categorizes certain patterns of trading conduct as constituting a *prohibited act* under Article (2), and a violation of one or more general prohibitions found in Articles (107)-(109) of The Securities Law (No. 76) for the Year 2002 (hereinafter referred to as the "Securities Law" or the "Law"), respectively. The second instruction, entitled "Instruction on Burden of Proof", defines in specific terms the amount or quantum of evidence that the Commission must produce in order to prevail in a civil or administrative enforcement action. Both instructions are believed necessary for the Commission to exercise its enforcement powers fairly and consistently within the Law's framework.

The document is divided into three main parts denoted by Roman numerals. Part I articulates the legal authority for the Commission to issue the two instructions under Articles (2), (8), and (12) of the Law. Part I also explains the underlying rationale or necessity for the issuance of the respective instructions. The substance of Part I should foreclose possible legal challenges to the Commission's authority to issue these instructions in the first instance.

Part II defines and categorizes nine distinct types of trading activities as constituting a *prohibited act* and a violation of one or more provisions of the Law's broadly-worded trading prohibitions: (1) Article (107) – Trading Away, Wash Sales/Prearranged Trading, Marking the Open/Close, and Spoofing/Scalping; (2) Article (108) – Front Running Research, Front Running Client Orders, and Trading on the Basis of *Inside Information*; and Article (109) – Price and Volume Manipulation and Pump and Dump Fraud. For each trading violation, the text includes a statement defining the prohibited conduct (in bold type); a rationale as to why the defined conduct violates the cited Article of the Law; and a hypothetical example of a scenario that would be deemed a violation of the subject Article. Finally, the discussion of each violation concludes with a summary of the key factual elements that would normally have to be demonstrated to support a finding that the alleged violation occurred, in the context of a civil or administrative enforcement proceeding.

Part III consists of the Instruction on Burden of Proof. This Part repeats, in summary form, the rationale and legal basis for this particular instruction found in Part I. Part III also contains the specific statement of burden of proof in bold type. This approach allows the Commission the flexibility of issuing both instructions in a single document, or as separate documents with relatively little editing required.

Assuming that the Commission ultimately determines to issue the proposed Instructions, it is recommended they be issued together. This sequencing is appropriate because the Instruction on Burden of Proof mainly affects the Commission's exercise of enforcement powers in the context of prosecuting complex trading cases where it is rare for the responsible parties to admit their guilt.

I. Legal Basis and Rationale for Issuing Instructions

A. Statement of Legal Basis

The Securities Law (No. 76) for the Year 2002 (hereinafter referred to as the "Securities Law" or the "Law") envisions that instructions will be issued from time to time to achieve the Law's regulatory objectives, including the fundamental objectives set forth in Article (8), paragraphs A.1-.3 and B.4-.5. Paragraph A charges the Jordan Securities Commission (hereinafter referred to as the "Commission") with responsibility for taking appropriate actions to protect investors, to protect and develop the nation's capital markets, and to protect that capital market from various risks that it might face. Paragraphs B.4 and .5 place responsibility with the Commission for monitoring the activities of *licensed and registered persons* in the capital market and for regulating and monitoring the *stock exchange and trading markets* in securities.[1]

Article (12) of the Securities Law complements Article (8) by specifying certain processes that the Commission's *board* shall use to carry out the organization's regulatory responsibilities. Paragraph A authorizes the *board* to formulate the Commission's general policy and develop the programs necessary for its implementation. Paragraph Q authorizes the *board* to issue "the required instructions . . . or decisions . . . to implement the provisions of this Law." Moreover, paragraph R authorizes the *board* to "prepar[e] draft laws and regulations related to securities." Finally, Article (2) grants the Commission (acting through its *board*) the authority to amplify or expand the meaning of the term *prohibited act* by issuance of regulations.[2] This last term is important because it appears in several parts of the Law that relate to the Commission's power to impose sanctions for conduct it deems to be a violation of the Law.

Accordingly, the Commission relies on the foregoing provisions of Articles (2), (8), and (12) of the Securities Law as its legal basis for issuing the instruction below on trading violations. This instruction pertains to the definition of certain trading practices or courses of conduct that would constitute a violation under Articles (107), (108), and/or (109) and prohibited acts as well.

The second instruction (found in Part III of this document) deals with the burden of proof or quantum of evidence required for the Commission to sustain a civil enforcement action based on evidence that a particular course of conduct constitutes a prohibited act and a violation of Articles (107), (108), or (109) of the Securities Law. Not only is the Law completely silent on this point, but it makes no reference to any other Jordanian law that might provide an appropriate standard. Given that the Commission can pursue both civil and criminal enforcement actions, it is important to define the burden of proof required in civil cases.

[1] Unless otherwise indicated, all italicized terms used in this instruction shall be defined according Article (2) of the Securities Law.

[2] The Securities Law currently defines *prohibited act* as "any action, practice, scheme, course of conduct, or device forbidden in this law or the regulations, instructions or decisions issued pursuant thereto".

Accordingly, the Commission relies on the authority granted to it under Articles (8)A.-B., and (12)A., Q., and R. as the legal basis for issuing the second instruction that defines the burden of proof to be satisfied to prevail in a civil enforcement cases initiated by the Commission.

B. Rationale for Issuance of Instructions

Currently, Articles (107), (108) and (109) of the Securities Law define certain courses of conduct that are prohibited, but they do so in very general terms. Indeed, widely recognized trading violations such as insider trading and various forms of market price and volume manipulation are not expressly defined by the Law. Instead, the foregoing Articles prohibit a range of fraudulent conduct or practices that should cover most trading violations commonly prosecuted by securities commissions and/or self-regulatory organizations globally. Given this circumstance, the Commission has determined to provide regulatory guidance in the form of an instruction that categorizes specific types fraudulent and/or manipulative activities as violations of one or more of these provisions of the Law.

The Instruction on Trading Violations provides regulatory guidance by enumerating representative types of conduct that are deemed to violate the provisions of Articles (107), (108), and/or (109) of the Securities Law and thus would likely result in the Commission's initiating enforcement action(s) against the persons who engaged in such conduct. Furthermore, the Commission expects that the Instruction on Trading Violations instruction will cause general mangers and compliance officers of financial services companies to review their internal compliance procedures to ensure that they are adequate to safeguard the clients' interests and protect the firm's reputation for honest and fair dealing in the securities business. These outcomes are fully consistent with the Commission's regulatory mandates under Article (8)A. and B. of the Law.

At the same time, the Commission's instruction makes clear that the courses of conduct detailed therein are not meant to be an all-inclusive listing of the types of conduct that would breach the prohibitions established by Articles (107)-(109). Rather, the categories of illicit conduct discussed in the instruction are illustrative. Similarly, the instruction recognizes that a particular course of conduct may violate more than one of these Articles. This element ensures that the Commission retains flexibility to deal with more severe instances of misconduct, which may require, for example, remedial measures in addition to the imposition of a punitive sanction on the party adjudged to have committed the violations.

In addition, the Commission is issuing a second instruction, the instruction on burden of proof. This instruction addresses the level or quantum of evidence required that the Commission must satisfy to prevail in any civil enforcement action, particularly actions grounded on charges that a party violated one or more provisions of the Articles (107)-(109) and the corresponding provisions of the Instruction on Trading Violations. The necessity for this instruction derives from three practical considerations. First, the

Securities Law is totally silent on this matter, and it is not addressed in any other legislation that would govern the Commission's exercise of its civil enforcement powers. Second, it is appropriate to distinguish the burden of proof in civil enforcement cases versus criminal enforcement cases because the Commission has the authority to initiate both types of enforcement cases. And third, the experience of securities regulators worldwide has demonstrated the need to clarify what the appropriate burden should be in light of the nature of securities violations that require a showing of intent to engage in a course of conduct that would constitute fraudulent or manipulative conduct.

Regarding this last point, it is relatively easy for any securities regulator to take enforcement action for violations that breach an objective standard defined in the securities law, e.g., failure to file a required annual report or failure to satisfy a capital adequacy standard. In contrast, the civil prosecution of violations involving fraudulent sales schemes, illicit insider trading or market manipulation require, for example, a showing of intent on the part of the responsible parties as well as evidence that the course of conduct contains all the factual elements comprising the legal definition of the violations being charged. Absent a confession of guilt, it is virtually impossible to compile conclusive evidence that a willful sales practice or trading violation occurred. Instead, the securities regulator (or self-regulatory organization) must build a compelling case based on circumstantial and documentary evidence from which the adjudicating authority can infer the party's intent to commit the fraudulent sales scheme, trade on the basis of inside information, or manipulate the market price of a particular security.

Therefore, for purposes of civil cases grounded on violations of the Securities Law -- and in particular, the provisions of Articles (107), (108), and (109) and the corresponding Instruction on Trading Violations, the Commission has determined to issue a separate instruction that establishes a "preponderance of evidence standard" as the burden of proof required for the Commission to prevail in its civil prosecutions of such cases.[3]

[3] The lone exception to this categorization is the Article (108)C violation, consisting of disclosure of inside information to parties other than a competent authority (e.g., the Commission) or the courts. This prohibition lends itself to an objective test, much the same as compliance with a filing requirement or capital adequacy standard.

II. Text of the Instruction on Trading Violations

A. Article (107)

Article (107) of the Securities Law contains four paragraphs. The first three focus on the accuracy of documents and data (including financial statements) that are filed with the Commission or used in connection with a public offering of securities. The fourth paragraph goes on to prohibit "*any deception or misrepresentation relating to securities or any prohibited act relating to licensed activities*…." Article (2) of the Law defines deception as "[a]n act, scheme, device, practice or course of conduct likely to have the effect of misleading others or intended to mislead them." Thus, Article (107)D establishes a prohibition of deceptive conduct related to securities or the business activities of a licensed intermediary that is independent of the circumstances envisioned by Paragraphs A.-C. of Article (107). Therefore, the Commission interprets Article (107)D as establishing a prohibition that applies to certain courses of dealings whose substance involves deception.

Without limiting in any way the scope of Article (107)D of the Securities Law, the following is a non-exclusive list of activities that the Commission deems to be violations of this provision of the Law.

(1) *Trading Away* – *It shall be a violation for a registered broker, employed by a financial services company, to execute a securities transaction for a client away from, and without the prior approval of the firm who employs the broker. Similarly, it shall be violation for a broker to trade for his own account away from, and without the prior approval of the firm who employs him. Such approval, if given, would normally be the responsibility of the firm's general manager or compliance officer.*

The foregoing types of conduct are violations of Article (107) D and are prohibited acts under Article (2) because of the deception involved in the broker's concealing the trades from his employer, and thereby avoiding his employer's supervision.

One example of this violation would be a scenario in which a broker brings a client to a third party who is seeking to make a private placement of securities, with the understanding that the broker will be compensated by the third party if his client buys some quantity of unregistered shares from the third party. Engaging in this activity without the broker's first obtaining his employer's approval would constitute the violation. A related example would consist of the same broker obtaining some of these unregistered securities as compensation for bringing his client to the private placement without the prior approval of his employer.

Generally, for a violation to be found, a registered broker must either (a) execute a securities transaction for a client of the firm outside the firm's supervisory system and procedures, and without the prior and specific approval of an authorized supervisor or (b)

execute a transaction for his own account, outside the firm's supervisory system and procedures and without the prior and specific approval of an authorized supervisor.

(2) *Wash Sales / Pre-arranged Trading* – *It shall be a violation for any person to use any facility of the market/stock exchange to execute a securities transaction involving no genuine change in beneficial ownership of the security.*

The foregoing conduct is a violation of Article (107) D and a prohibited act under Article (2) of the Securities Law because it involves a deceptive trading practice relating to a security. A deception occurs because the transaction itself is not a bona fide transaction between an independent buyer and seller, and because the market/stock exchange (as defined in Article (2)) is deceived because it treats the transaction as a genuine transaction by disseminating its price and volume to the general public.

Moreover, if a market participant engages in a pattern or practice of wash sales/pre-arranged trades in any security, this data shall also be regarded as prima facie evidence of intent to violate a Article (109) B of the Securities Law. Article (109) B prohibits effecting any transaction in a security with the intent of creating a false impression of the price or volume of trades in the subject security.

An example of a wash sale would be the circumstance where a buy order entered by client A through one intermediary is matched with a sell order submitted by client A, but through a different intermediary. Similarly, if client A submitted a buy order for his personal account and that order was matched with a sell order entered on behalf of a legal person controlled by client A, this conduct may also constitute a wash sale because the entry and execution of both orders were under client A's control.

An example of a wash sale with prearrangement would be the circumstance where client A agrees to sell shares to B, with the mutual understanding that B would resell the same shares back to A at or about the same price a short time later. Market participant B could be a client or a financial services company trading as a dealer.

Generally, for a wash sale violation to be found, there must be evidence of the entry and execution of offsetting buy and sell orders, under the ultimate control of the same market participant. Regarding prearrangement of wash sales, there must be evidence showing the purchase and resale of the same security, between same two (or more) market participants, that results in the initiating party retaining ownership or control of substantially all of the securities involved in the transactions.

(3) *Marking the Open / Close* – *It shall be a violation for any person to buy or sell securities at the open or close of trading on the market/stock exchange in an effort to alter, respectively, the official opening or the closing price of the subject security.*

Marking the open/close would constitute a deception relating to securities in violation of Article (107) D and a prohibited act under Article (2) of the Securities Law. The element

of deception arises from the entry and execution of one or more orders for the primary purpose of altering the official opening or closing price of the subject security.

Moreover, if a market participant engages in a pattern or practice of marking in one or more securities, this transactional data shall also be regarded as prima facie evidence of intent to violate Article (109) B of the Securities Law. That Article prohibits persons from effecting any transaction in a security with the intent of creating a false impression of the price or volume of trades in the subject security.

An example of marking would be the circumstance where a single market participant enters a series of small orders for his account, at progressively higher (or lower) prices in a less active security, shortly before the security's opening (or closing) on a given business day. One or more of these orders is executed, with the result that the security's opening (closing) price is higher (lower) than would otherwise be the case.

For a violation to be found, there must be a showing that, in the context of the market conditions in the security, the terms, timing and execution of the order(s) in question reflected the market participant's intent to influence the subject security's opening (or closing) price. This intent may be inferred, for example, in the circumstance where an executed order's price is rejected by the market/stock exchange in determining the security's official opening (or closing) price on a given business day. An inference of intent may also result from documentary evidence showing some form of economic benefit accruing to the party as a result of engaging in the apparent marking activities.

(4) *Spoofing/Scalping* – *It shall be a violation for any person to engage in the practice of entering and canceling limit orders on one side of the market in a security for the purpose of inducing other market participants to cancel or adjust the prices of their orders, in order to provide the responsible person with a more favorable execution for his subsequent order in the same security.*

Spoofing/scalping would constitute a violation of Article (107) D and a prohibited act under Article (2) of the Securities Law because it involves a deception relating to a security. The element of deception arises because the party's entry and cancellation of "spoof" orders on one side of the market is done to mislead other market participants and cause a temporary price manipulation from which the trader benefits by executing a subsequent order. Thus, the responsible person receives a better execution price due to the market impact of his earlier order entry and cancellation activities in the security. Likewise, if a market participant were to submit a sell order whose size exceeded the position that he held in that security at the time of the order's submission, that could be additional evidence of intent to deceive in the context of an apparent spoofing/scalping situation.

Moreover, if a market participant engages in a pattern or practice of spoofing/scalping in one or more securities, this transactional data shall also be regarded as prima facie evidence of intent to violate Article 109 B, which prohibits any transaction in securities done with the intent of creating a false impression of the price or volume of trades in the

security. Thus, intent may be inferred from transactional data illustrating multiple instances of spoofing/scalping by the same market participant, whether through one or several licensed intermediaries.

An example of spoofing/scalping would be a party's entry of a large, non-marketable limit order to sell (i.e., the spoof order) at a price that set a new "top-of-the- book" price for the sell side. Shortly after, other market participants on the sell side enter limit orders that match or better the price of the spoof order. The responsible party cancels the spoof order to sell and simultaneously enters an order to buy that is promptly executed at the price level induced by his earlier spoof order to sell.

Generally, for a violation to be found, there must be a showing that: (a) the responsible party entered and cancelled limit orders on one side of the market in a security; (b) that his actions quickly prompted other market participants to adjust the prices of existing limit orders on the same side of the market (or to enter new ones) to price levels that equaled or bettered the price set by the apparent spoof order, and (c) that the party responsible for the spoof order cancelled it and entered another order (on the opposite side of the market) at about the same time and received a more favorable execution as a result of the price change induced by the spoof order.

B. Article (108)

Article (108) of the Securities Law consists of three paragraphs, A., B., and C that deal with different forms of abuse of *inside information.* The first two generally deal with abuse of *inside information* for some form of gain (i.e., material or moral) by trading, either for one's own benefit or that of another person (i.e., either a natural or legal person). The third paragraph operates independently of the first two and simply prohibits disclosure of *inside information* to anyone other than a competent authority or a court.

Without limiting in any way the scope of Article (8) A. and B. of the Securities Law, the following is a non-exclusive list of activities that the Commission deems to be violations of these provisions of the Law and *prohibited acts* under Article (2).

(1) *Front-running research* – *It shall be a violation to establish, increase, decrease, or liquidate a position in any security for the trader's economic benefit or that of his employer (e.g., a financial services company) in anticipation of the issuance of a research report on that security (or its issuer) prepared by, or involving in any active way, the trader or his employer (e.g., a financial services company). Moreover, a violation would exist if the front-running transaction is executed for the benefit of the trader's personal account or the benefit of any other account that he controls or for which he has the authority to execute trades, including his employer's proprietary account for dealer trading.*

Until the research report is actually published, its content remains *inside information* as defined in Article (2) of the Securities Law, and trading on the basis of that information would violate Article (108) A and/or B, and constitute a prohibited act under Article (2).

An example of this violation would be a broker selling shares from his personal account (or another that he controls) based on foreknowledge that his employer, a financial services company, will shortly publish a negative research report regarding the business prospects of the issuer of the subject security.

Generally, for this type of violation to be found, there must be a showing that: (a) the negative (positive) research report was actually issued; (b) the trader had access to the content of the report prior to its issuance; (c) the related order and trade occurred before the time of the report's issuance; and (d) the trader derived a gain (or avoided a loss) as a consequence of the research report's immediate impact on the security's price following the report's public dissemination.

(2) *Front-running client orders* – *It shall be a violation to execute a transaction in any security, for the trader's own economic benefit or that of his employer (e.g., a financial services company), on the basis of, and ahead of, an order that the trader and his employer are obliged to execute for a client with whom a fiduciary relationship exists. This relationship exists whenever the client of registered intermediary gives an order to buy or sell securities to that intermediary through the facilities of the market/stock exchange.*

The foregoing conduct constitutes a violation of Article 108 A. and/or B., and a prohibited act under Article (2) because the trader seeks to reap an economic gain based on foreknowledge of the terms of a client's unexecuted order that, when executed, would likely affect the security's price. By front-running his client's order, the trader breaches the fiduciary obligation owed to that client by virtue of the client's contractual relationship with the executing broker and firm. That relationship requires that the firm and its broker subordinate their respective economic interests to the client's interests in order to obtain the best possible execution for the client's orders, subject to prevailing conditions in the marketplace. Moreover, front-running a client's order would also be a violation of Article (108) A. and or B. where the executing broker has discretionary authority to trade on behalf of the client's account. In any event, the terms of the unexecuted client order constitute a form of *inside information*, as defined in Article (2) of the Securities Law, until such time as the client's order is actually executed.

An example of this violation would be a broker buying shares for his firm's proprietary account based on knowledge of a client's pending block order to purchase the same shares at a limit price above the security's current market price. On the basis of this knowledge, the trader executes a trade in the same security for his personal account. Then, he captures his illicit profit by liquidating the shares that he had purchased shortly after executing the block transaction for the client.

Generally, for a violation to be found, there must be a showing that: (a) a broker-client relationship existed between trader's employer and the client whose order provided the front-running opportunity; (b) the trader had foreknowledge of the terms of the

unexecuted client order; and (c) the trader reaped a profit (or avoided a loss) by trading ahead of the execution of that client's order.

(3) *Trading on the Basis of Inside Information* – *It shall be a violation of Article (108) and a prohibited act under Article (2) for a party to engage in any of the following activities:*

(a) Buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of inside information about a given security or its issuer (a violation of Paragraph A.);

(b) Tipping or disclosing inside information to persons other than the competent authorities or the courts, where it reasonable to expect that the person receiving the inside information will trade on the basis of the illicit disclosure (a violation of Paragraph A. or B. and C.);

(c) Buying or selling a security on basis of the inside information received as a result of a tip or other illicit disclosure made by an insider (a violation of Paragraph A. or B.); or

(d) Buying or selling a security on the basis of inside information by using the account of another person, where trading in such person's account is controlled by someone who is either an insider or becomes privy to inside information as a result of a tip or other illicit disclosure by someone possessing inside information (in violation of Paragraph A or B).

An example of illicit insider trading would be the case where a corporate attorney opens a securities account for a grandparent with a power of attorney to trade for that account. The attorney uses this account to purchase 2,000 shares of company ABC, which will shortly become the target of a takeover by company XYZ. The attorney took this action after learning from his fiancé about the potential takeover. The fiancé works for another law firm who is advising XYZ on its takeover strategy. The takeover is announced two days later and the price of ABC spikes upward. Both attorneys have violated various provisions of Article 108.

In general, to prove an insider trading violation, there must be a showing of actual trading of a security on the basis of *inside information* either by (a) an *insider* who breached a duty of trust or confidence, or (b) a person who received an illicit disclosure of *inside information*, and who knew or should have know that it was *inside information*. It is therefore relevant to compile evidence showing a link between an authoritative source for the *inside information* and the party who actually traded while in possession of *inside information*. It is also relevant to the proof of intent that the timing and circumstances of the questionable trading actually yielded some form of material or moral gain for the person to be charged with violating paragraphs (A) or (B) of Article (108). Again, the

breadth of evidence needed to prove the case will be a function of the complexity of the fact pattern. There are too many possible permutations to be able to generalize further.

C. Article (109)

Article (109) of the Securities Law contains two paragraphs, A. and B. The first generally prohibits the dissemination of false or misleading information and rumors with the intent to affect a security's price directly, or indirectly by promoting (or attacking) the business prospects or reputation of a security's issuer. The second paragraph deals broadly with trading activities that are intended create a false impression of the market price or volume of trading activity in a security. Thus, paragraph A. prohibits schemes to manipulate a security's price by disseminating false/misleading information while paragraph B. prohibits trading activities that have a manipulative impact on a security's price or volume in the *market/stock exchange*.

Without limiting in any way the scope of Article (109) of the Securities Law, the following is a non-exclusive list of activities that the Commission deems to be violations of Article (109) and *prohibited acts* under Article (2) of the Law.

(1) *Price/Volume Manipulation – The following activities are deemed to be forms of market price and/or volume manipulation that would violate Article (109):*

> ***(a) Disseminating rumors, false or misleading information and/or reports, including investment research reports or investment strategies based on exaggerated or unfounded information on the business prospects of any company whose securities traded on the market/stock exchange (a violation of Paragraph A.);***
>
> ***(b) Using orders or transactions that give, or are likely to give, a false or misleading impression as to the supply of, demand for, or current market price of any securities traded on the market/stock exchange (a violation of Paragraph B.); or***
>
> ***(c) Using orders or transactions to peg or maintain the price of any securities on the market/stock exchange at an abnormal or artificial level (a violation of Paragraph B).***

An example of market price manipulation would be a case where a particular market participant determines to dominate the market in a given security for a specific time period. Market domination can be characterized by a single intermediary executing a disproportionate volume of trades (typically on the buy side) in a single security on behalf of a single customer or the firm's own account. The objective of the dominant market participant is to stabilize the security's price at or around a particular level that holds some economic value for that participant. (e.g., the participant may have pledged several thousand shares of the subject security as collateral for a loan and wants to avoid the possibility of a call for additional margin by setting a "floor" for the security's price.

Or, the motivation may be to maintain a security's price at a given level may be driven by the party's position in an overlying derivative instrument that is at or approaching expiration.)

Alternatively, the motivation could be to dominate the security's market in order to control the supply of securities and be able to manipulate the issue's price upward. This strategy is often facilitated by an aggressive sales campaign whereby the dominant firm disseminates false and/or misleading information about the security to induce clients to make purchases at increasingly higher prices. The dominant firm's ultimate objective is to liquidate its holdings at a profit by selling into the demand created by its sales campaign.

Other examples of specific trading abuses that may constitute market price or volume manipulation and therefore a violation of Article (109)B. were described earlier in this Instruction on Trading Violations, e.g., marking the open/close, wash sales/prearranged trades, and spoofing/scalping.

Generally, because price manipulation may take many forms, the factual elements required to prove a violation will vary depending on the nature and complexity of the apparent manipulative activities. However, most cases involve a reconstruction of market activity (from transaction and order audit trails) to show a pattern of activity or a business strategy that is designed to interfere with the legitimate supply and demand factors that normally set the market price of a security. To assist in demonstrating intent, to commit the violation, it is typically necessary to show that an economic benefit was derived from the manipulative actions of the responsible party.

(2) ***Pump and Dump Fraud/Price Manipulation*** ***– It shall be a violation for any party, whether acting alone, in collusion with others, to engage in a pattern of fraudulent and manipulative activities characterized by: (i) an orchestrated campaign to disseminate false, misleading, and/or exaggerated information about the business prospects of an issuer; (ii) to stimulate investors to purchase that company's securities at increasingly higher prices; and (iii) to enable the persons orchestrating the scheme to profit by liquidating ("dumping") their holdings at the abnormal price levels achieved by the sales campaign (i.e., the "pump"). Thereafter, the security returns to the approximate price levels that existed before the scheme was launched, and its daily transaction volume will fall commensurately.***

The foregoing course of conduct is deemed to be a severe violation of the law because it combines fraudulent sales practices and a calculated effort to manipulate the market price of a security. Essentially, the sales campaign induces buying interest and increased transaction volumes that cannot be justified in light of the issuer's public disclosures of its financial condition and business prospects. This "induced activity" often draws additional speculative interest into the market place, thus increasing the upward momentum attributable to the fraudulent sales activities and providing additional opportunities for the perpetrators to liquidate their holdings profitably. After the

perpetrators have liquidated their holdings, the security's price will drop rapidly back the levels that existed prior to the start of the scheme. In the end, the perpetrators' actions have resulted in a fraud on the market for the subject security and a fraud against those investors who were induced to purchase as a consequence the sales campaign or the illusion of favorable market price and volume conditions in the security.

Generally, proof of the foregoing violation will involve a reconstruction of the sales campaign, a showing of its impact on the securities daily price and volume movements during the course of the scheme, and the incurrence of a profit by the parties responsible for orchestrating the pump and dump scheme.

III. Instruction on Burden of Proof

A. Background

At this time the Commission has simultaneously issued a related Instruction on Trading Violations which specifies certain courses of conduct that the Commission deems to be violations of Articles (107), (108), and (109) of the Securities Law and *prohibited acts* under Article (2). The Commission has determined to issue this Instruction on Burden of Proof to clarify the burden of proof that the Commission must satisfy when it initiates a civil enforcement action for violations of the Law generally, and with particular reference to the trading violations covered by the Instruction on Trading Violations.

This instruction is necessary for several reasons. First, the Securities Law is silent on this important policy issue, despite the fact that the Law authorizes the Commission to pursue both civil and criminal remedies in response to detecting apparent violations of the Law's diverse requirements and prohibitions. Second, it is a recognized principle of law in virtually every country that the burden of proof for a regulator's taking enforcement action through a civil or administrative remedy will be lower that an action that invokes the State's criminal enforcement powers and possibility of more severe sanctions, including imprisonment. Finally, the Commission acknowledges that its statutory authority allows it to pursue civil or administrative enforcement actions against persons found to have engaged in fraudulent sales and/ or abusive trading practices that are not susceptible to a narrow legal definition. Accordingly, the Commission finds that it is both necessary and appropriate to articulate the burden of proof or quantum of evidence that it should meet to prevail in a civil or administrative enforcement action against any person.

B. Legal Basis for Issuing the Instruction

The Commission relies on the authority granted to it under Articles (8) A.-B., and (12) A., Q., and R. of the Securities Law as the legal basis for issuing this Instruction on Burden of Proof applicable to the exercise of its enforcement powers through civil or administrative proceedings authorized by the Law.

C. Statement of Burden of Proof

In taking any civil or administrative enforcement action against any person charged with violating a provision of the Securities Law or the instructions issued there under, the Commission shall prevail only if it can show, by a preponderance of evidence (i.e., at least 51%), that the occurrence of the violation being charged is more likely than not to have occurred, given the facts and circumstances of the particular case. Moreover, in prosecuting most fraud and trading violations that require a showing of intent, it is permissible for the adjudicating authority to infer the required intent from reliable circumstantial and documentary evidence introduced to support a finding of the violation(s) charged.

The persons charged with having violated the Securities Law in a civil or administrative proceeding shall have a fair and reasonable opportunity to introduce countervailing evidence to rebut any evidence introduced by the Commission and any inferences that might be drawn from the Commission's evidence.

This Instruction shall have no legal effect whatsoever on the burden of proof that the Commission must satisfy in order to prevail in a criminal enforcement matter charging violations of the Securities Law.